

## Internal Revenue Service

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Washington, DC 20224

Third Party Communication: None

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Date: March 6, 2008

### LEGEND:

A =

B =

X =

Y =

Trust =

Company =

State =

Year 1 =

Date 1 =

Date 2 =

a =

b =

c =

d =

e =

f =

g =

Dear

This responds to a letter dated September 14, 2007, and subsequent correspondence, submitted on behalf of X by X's authorized representatives, requesting rulings under §§ 704, 731, and 737 of the Internal Revenue Code.

The information submitted states that Trust was created on Date 1. The remainder beneficiaries of Trust are A and B. In Year 1, Trust formed X and Y. Y is a limited liability company formed under the laws of State. Because Trust owned all of the interests in Y, Y was disregarded as an entity separate from Trust for federal income tax purposes. X is a State law limited partnership. Upon formation of X in Year 1, Y served as the sole a% general partner and Trust served as the sole b% limited partner. Because both Y and Trust were the only partners of X, and Y was disregarded from Trust, X was also deemed to be disregarded from Trust for federal income tax purposes.

Upon formation of X, Trust contributed to X various highly appreciated assets for State law purposes, including c shares of Company. Trust continued to own these assets outright for federal income tax purposes. All of the shares of Company held directly by Trust were originally acquired by Trust in the same year and have the same cost basis and holding period.

On Date 2, as a result of the death of the income beneficiary, Trust distributed d% of the limited partnership interests in X to A and e% of the limited partnership interests in X to B (the "Trust Distribution"). Trust retained an f% limited partnership interest and a% general partnership interest in X.

It is now proposed that X will distribute up to d% of the shares of Company held by X to A and up to e% of the shares of Company held by X to B through a series of partial redemptions of the partners' partnership interests (the "Redemption Distribution"). X requests a ruling that the Redemption Distribution will be considered a distribution of property which was previously contributed by A and B for purposes of §§ 704(c)(1)(B), 731(c)(3)(A)(i), and 737(d)(1) of the Code.

## LAW AND ANALYSIS

In Rev. Rul. 99-5, 1999-1 C.B. 434, Situation 1, LLC, which for federal tax purposes is disregarded as an entity separate from its owner, is converted to a partnership when the new member, B, purchases an interest in the disregarded entity from the owner, A. B's purchase of 50 percent of A's ownership interest in the LLC is treated as the purchase of a 50 percent interest in each of LLC's assets which are treated as held directly by A for federal tax purposes. Immediately thereafter, A and B are treated as contributing their respective interests in those assets to a partnership in exchange for ownership interests in the partnership.

Section 704(c)(1)(B) requires a contributing partner to recognize gain if property contributed to a partnership is distributed by the partnership (other than to the contributing partner) within 7 years of being contributed to the partnership.

Section 731(a)(1) provides that when a partnership makes a distribution to a partner, gain shall not be recognized to the distributee partner except to the extent that any money distributed exceeds the adjusted basis of such partner's interest in the partnership immediately before the distribution.

Section 731(c)(1) provides that for purposes of §731(a)(1) the term "money" includes marketable securities. Section 731(c)(3) provides that §731(c)(1) does not apply to a distribution of marketable securities from a partnership to a partner if the security was contributed to the partnership by that partner, except to the extent that the value of the distributed security is attributable to marketable securities or money contributed (directly or indirectly) to the entity to which the distributed security relates.

Section 737(a) provides that a partner that contributed property to a partnership may recognize gain if the partnership distributes property to him within 7 years of the contribution. Section 737(d)(1) provides that any portion of a distribution that consists of property that had been contributed by the distributee partner to the partnership is not taken into account under §737 (a) (1).

Upon the Trust Distribution, X was converted from a disregarded entity to a partnership, similar to Situation 1, in Rev. Rul. 99-5. The distribution of interests in X by Trust should have been treated as a non-taxable pro rata distribution of d% of X's assets to A and e% of X's assets to B, including the shares of Company, as if such assets had been distributed outright from Trust to A and B. A, B, and Trust were then treated as contributing their respective interests in those assets (d%, e%, and g% respectively) to X in exchange for ownership interests in X in a transaction governed by § 721(a). Rev. Rul. 99-5, Situation 1. X represents that it will separately track any shares of Company that it may acquire in the future to the extent those shares have different tax attributes than the shares contributed by A, B, and Trust on the date of the Trust Distribution.

Based upon the information submitted and the representations made, we conclude that the Redemption Distribution will be considered a distribution of property which was previously contributed by A and B for purposes of §§ 704(c)(1)(B), 731(c)(3)(A)(i), and 737(d)(1) of the Code.

Except as specifically ruled upon above, we express no opinion on the federal tax consequences of the transactions described above under any other provisions of the Code and regulations or about the tax treatment of any conditions existing at the time of, or effects resulting from, any transaction that is not specifically covered by the above rulings.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Pursuant to a power of attorney on file with this office, a copy of this letter is being forwarded to X's authorized representative and X's second authorized representative.

Sincerely,

/s/

David R. Haglund  
Senior Technician Reviewer, Branch 1  
(Passthroughs & Special Industries)

Enclosures (2)  
Copy of this letter  
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